

Russia and Third EU Energy Package in gas: from a chain of three consecutive LTCs to “entry-exit” regional zones with virtual trading points. Key risks & uncertainties & how to reach their tolerable level within mutually beneficial solutions

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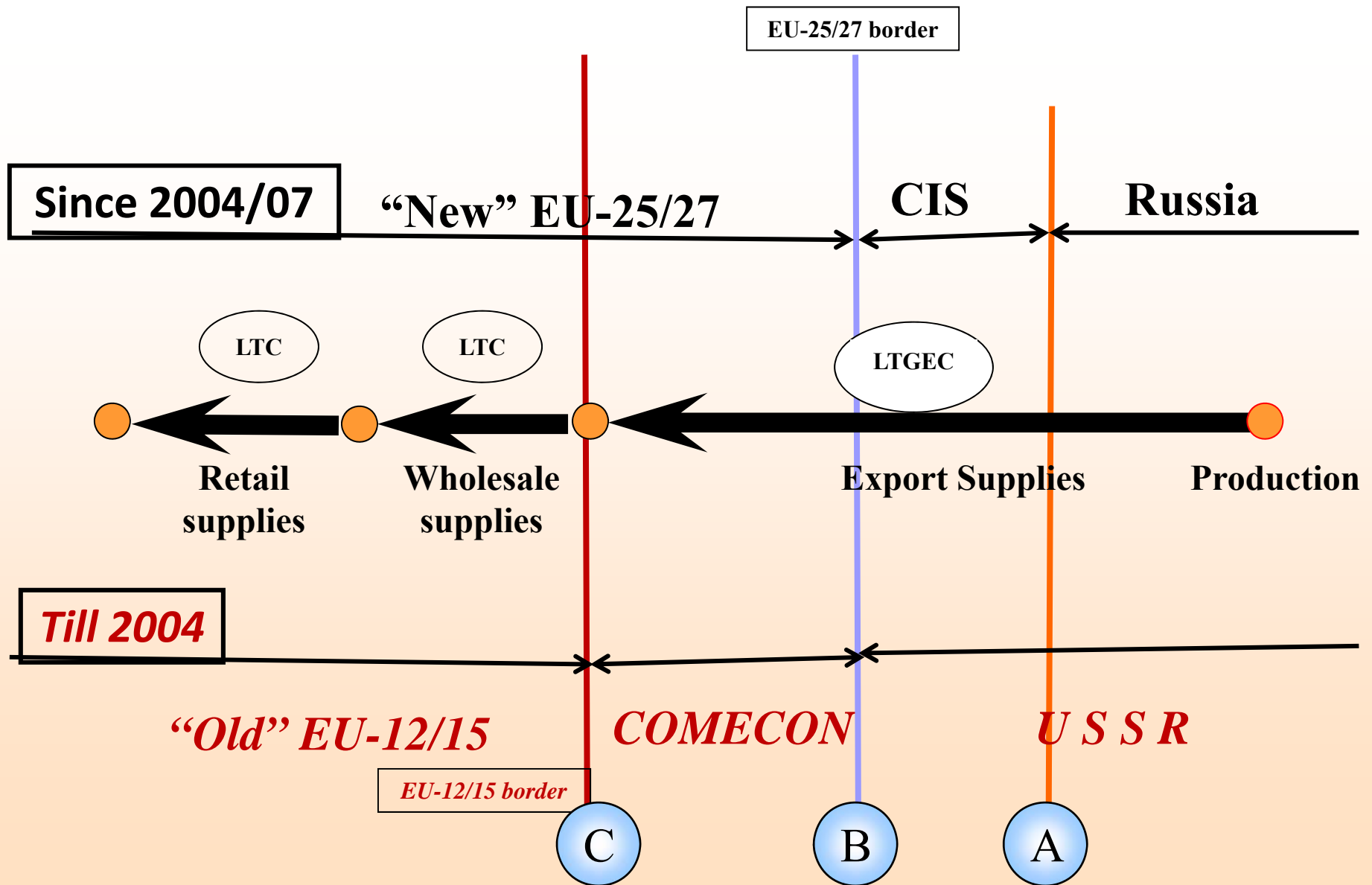
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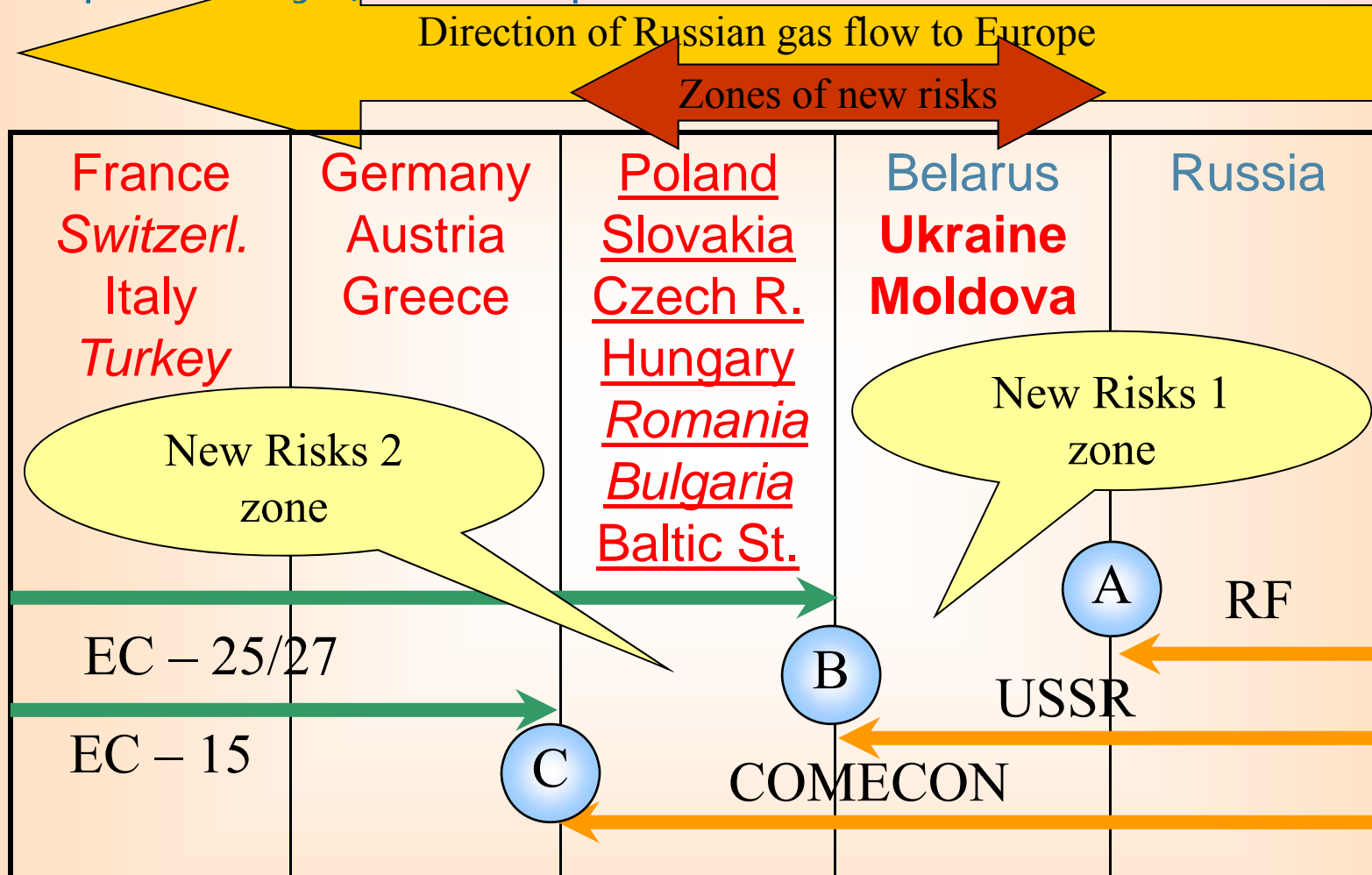
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- **Soviet/Russian gas supplies prior to Third EU Energy Package - & key risks & uncertainties after dissolution of the USSR**
- EU gas market structure under 3rd Energy Package: new risks & uncertainties for non-EU suppliers & how to overcome them
- Gas pricing scenarios for EU gas market: what type of compromise might be possible

Historical Russia-EU gas supply chain

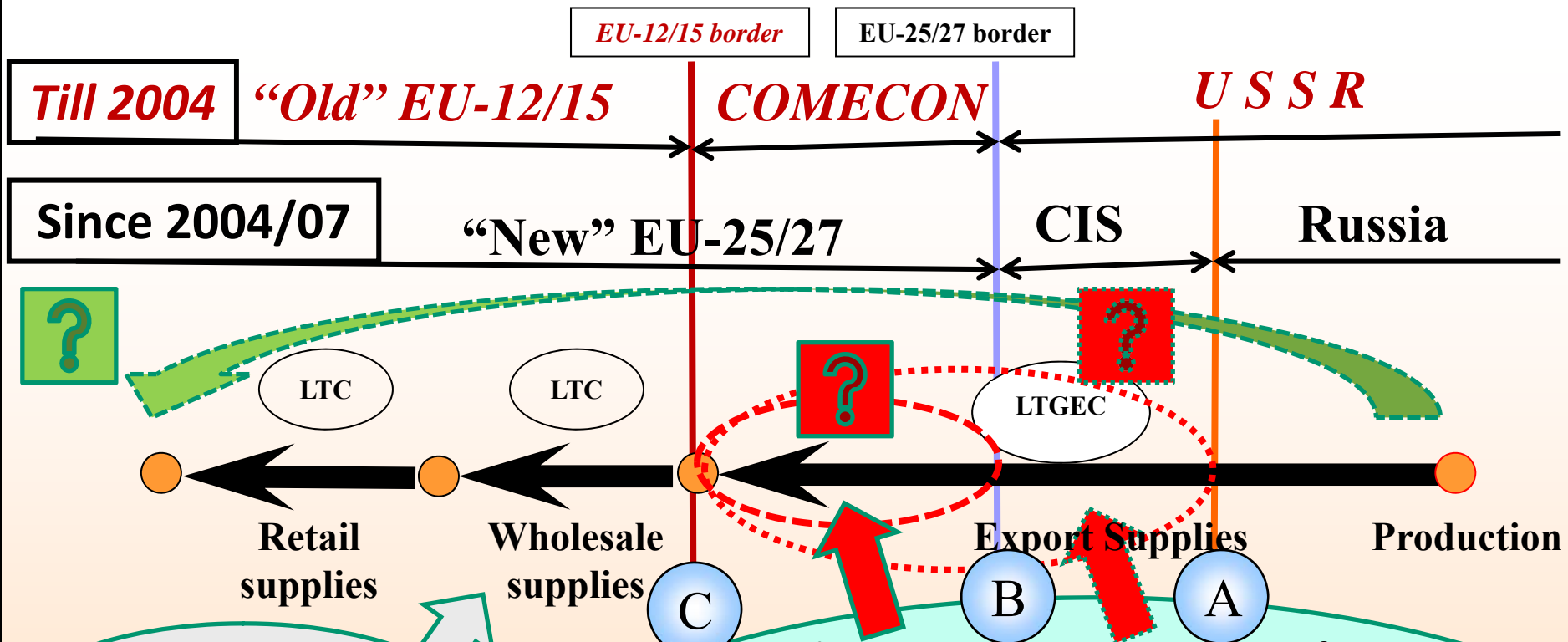


Russian gas supplies to Europe after USSR & COMECON dissolution:
 zones of new risks for existing supplies within Russia's area of responsibility (zones of potential "contractual mismatches")



Italic – non-EU countries; New EU accession states: underlined – since 01.05.2004, underlined + italic – since 1.01.2007; **bold** – non-EU members of Energy Community Treaty ; A, B, C – points of change of ownership for Russian gas and/or pipeline on its way to Europe

Third EU Energy Package affects Russia-EU Gas supply chain: how to materialize potential benefits



Third EU Energy Package = reform of internal EU wholesale trade ...

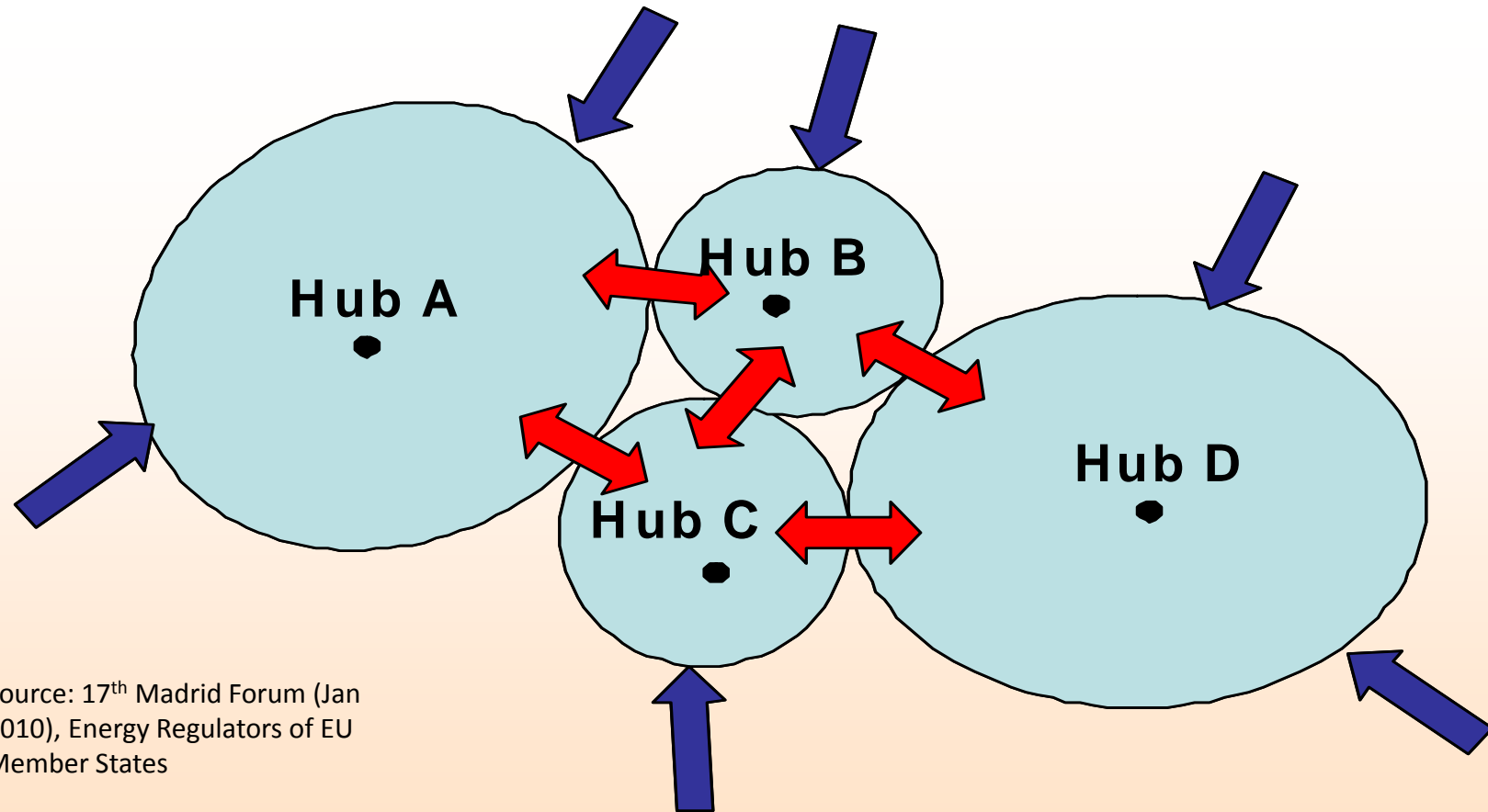
... BUT direct economic consequences for Russian LTGEC both within the EU & Energy Community Treaty area, both clearly conflicting with existing trade model (in-EU on-border supplies to wholesale EU importers) but **potentially positive for new/adapted trade model (direct access to end-users)**

Informal consultations/WS-2 RF-EU GAC concentrate mostly on these aspects of EU TEP

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EU internal gas market architecture according to Third EU Energy Package (entry-exit zones with virtual trading points/hubs)



Source: 17th Madrid Forum (Jan 2010), Energy Regulators of EU Member States



Pipelines-interconnectors
between EU zones



Supplies to the EU from non-EU

Third EU Energy Package in gas: development

Announced Sept.2007, entered into force 03.09.2009, was to be transposed into national laws by 03.03.2011; as of today most of (not all) EU MS has transposed...

← Step 2 Step 1 → Factual order of preparation

Step 1 Step 2 → Preferable order of preparation

3rd EU Gas Directive 73/EC/09 (on common rules in gas)

Regulation 713/2009
(ACER)

Regulation 715/2009
(access to natural gas networks)

EU Gas Target
Model

Step 2

Framework
Guidelines

Step 1

Network
Codes

Step 1

Step 2

1

12

12

GTM preparation was initiated, inter alia, at first round of informal Russia-EU expert consultations on EUTEF (Jan'2010)

Work in progress – to be finished by end-2014? Still window of opportunities!!! Incl. for RF-EU energy cooperation!!!

Whether 3rd EU Energy Package will overcome investment-related inefficiencies of 2nd EU Energy Package?

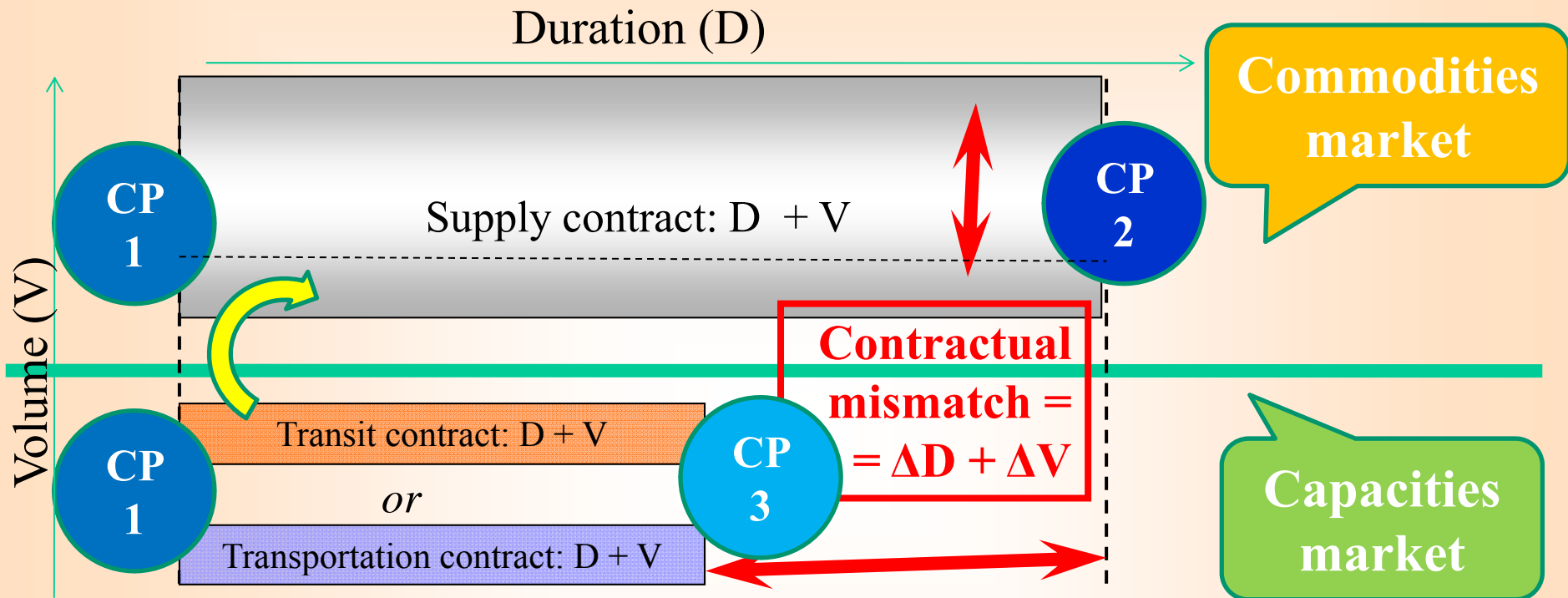
- **2nd EU Energy Package (2003):**

- Unbundling => separation of commodities & capacities markets => risk of “contractual mismatch”
- MTPA => risk for Project Financing (risk for pay-back of CAPEX)
- 2nd Gas Directive Art.21-22 => derogation from core EU rules as a mainstream for investing in infrastructure => 22 major EU infrastructure projects (pipelines + LNG terminals) developed on the basis of Art.21-22

- **3rd EU Energy Package (2009):**

- Investors expectation: 3rd package will establish rules which will enable to develop infrastructure projects WITHOUT any derogations, BUT
- Real life: concentration on derogations from the rules (3rd Gas Directive Art.35-36) as mainstream of investor-friendly EU regulatory development

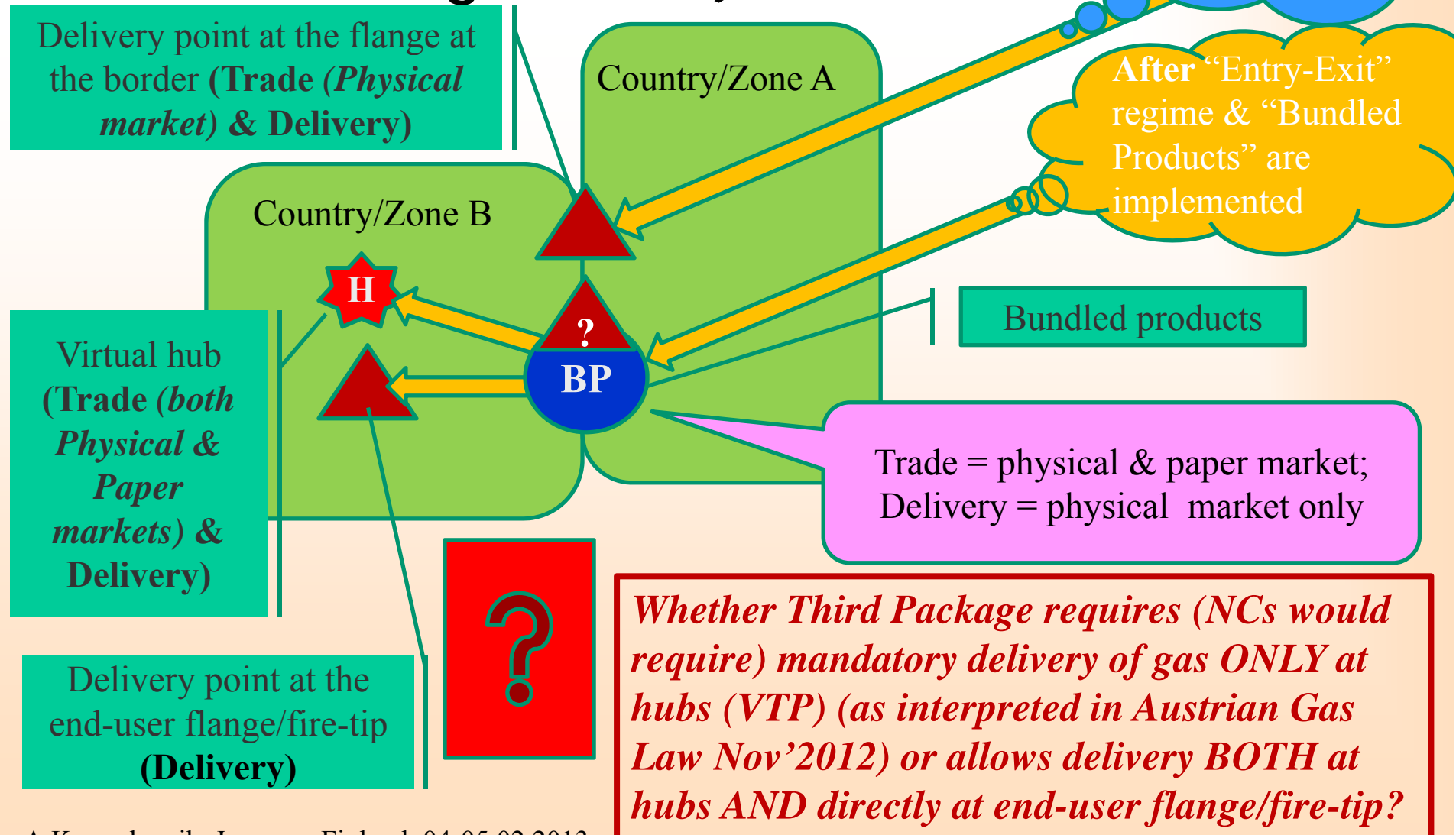
“Contractual Mismatch” problem: major risk for contract parties in unbundled gas market



Contractual mismatch: between duration/volumes (D/V) of long term supply/delivery contract (LTGEC; CP1-CP2) and transit/ transportation contract (CP1-CP3); the latter is integral part to fulfill the delivery contract => risk non-renewal transit/ transportation contract => risk non-fulfillment supply/delivery contract.

Core issue: guarantee of access to/creation of adequate transportation capacity for volume/duration of long term contracts

Substance of debate on transition from point-to-point to entry-exit system (*one*-segment or *two*-segment EU Gas Target Model)



Vision of possible “two-segment” EU gas market model under GTM (RF proposal for discussion & consideration within RF-EU Consultations/WS-2 GAC)

➤ Long-term supplies (firm contracts, main/basic demand load):

More flexible LTGEC (re off-taking of contractual volumes (TOP), pricing formulas & price review rules)

+ long-term access to transportation capacity for full duration & volume of LTGEC (open seasons)

+ modified pricing formulas linking gas to its replacement fuels (indexation not only to petroleum products => coal, RES, spot, etc.)

➤ Short-term supplies (interruptible contracts, additional/semi-peak & peak demand load):

Spot contracts & prices (delivery & trading) => (physical market)

+ exchange pricing (futures..., gas indexes, forward curves) => (paper market)

US & UK gas market models are not appropriate in Continental Europe/Eurasia (“Putting a price on Energy”, Energy Charter Secretariat, Brussels, 2007)

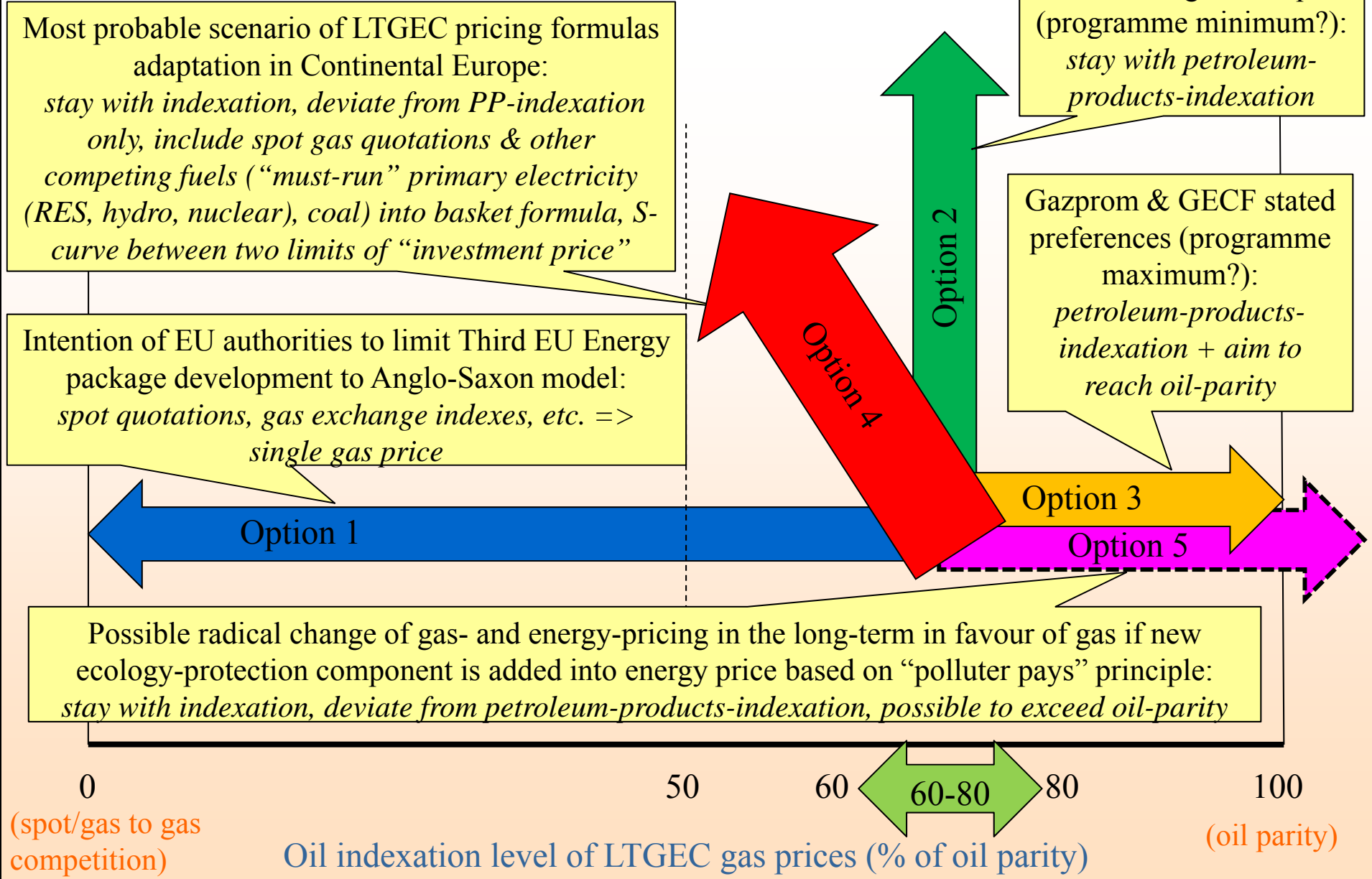
Initially GTM did not consider risks & uncertainties for this market segment => these questions have been added on a step-by-step basis in result of RF-EU informal expert Consultations

Initial drafts of GTM covered only this segment of gas market, long-term long-distant supplies and related risks & uncertainties stayed beyond consideration of justified concerns of market participants

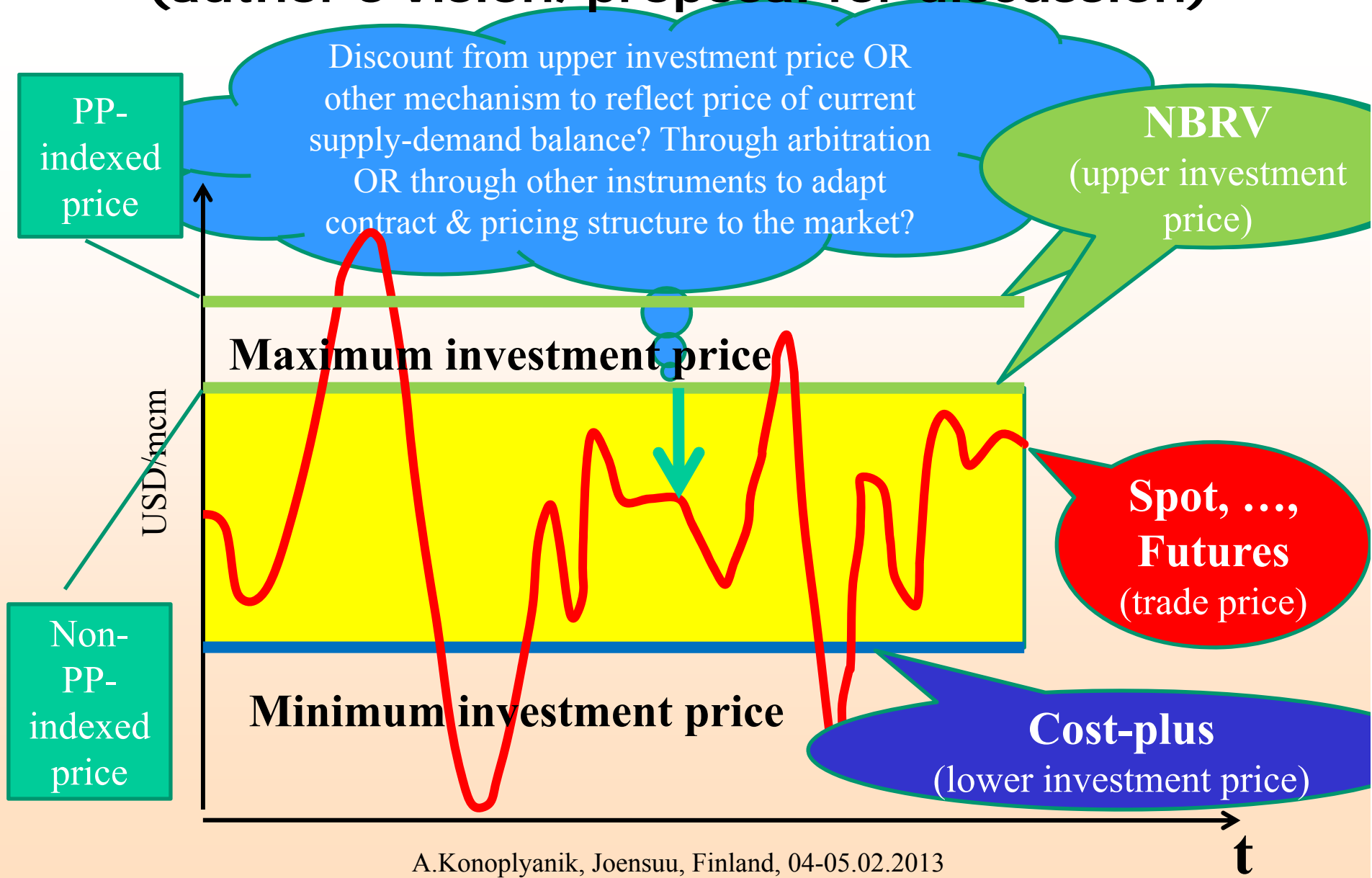
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Evolution/adaptation of gas pricing mechanisms in Europe: major options



S-curve approach for indexation in Continental Europe within contractual pricing (author's vision/proposal for discussion)



**Thank you for your
attention!**

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